



*Analyzing Taxpayer Errors Can Help to
Improve Forms and Instructions*

June 11, 2009

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 11, 2009

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM:

Michael R. Phillips
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Analyzing Taxpayer Errors Can Help to Improve
Forms and Instructions (Audit # 200830011)

This report presents the results of our review to determine whether an analysis of Individual Master File¹ math error notices² could help the Internal Revenue Service (IRS) identify areas on its individual income tax forms and instructions that need improvement and/or clarity. This review was included in the Treasury Inspector General for Tax Administration Fiscal Year 2009 Annual Audit Plan under the major management challenge of Processing Returns and Implementing Tax Law Changes.

Impact on the Taxpayer

Past estimates indicate that the IRS annually sends more than 7 million math error notices to taxpayers informing them that changes were made to their tax returns as a result of mathematical or clerical errors they made on their returns. Many of the errors are due to complex calculations and others are just simple mistakes. However, some errors could result from unclear or inadequate forms and instructions and could signal specific areas where the IRS could make improvements. Changes to tax forms and instructions could reduce some of the errors made by taxpayers on their individual income tax returns. Moreover, simplifying the filing process of taxpayers by clarifying forms and instructions increases compliance and reduces burden.

¹ The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.

² A math error notice is sent to a taxpayer when the IRS makes a correction to a tax return to explain the changes to the taxpayer who filed the return. The notice explains the nature of the changes and how the changes affected the tax return.



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Synopsis

The Tax Forms and Publications function has not effectively used an analysis of math errors made by taxpayers to help identify improvements or needed changes to forms and instructions. Math errors are mathematical or clerical errors (e.g., error on exemption computation, refund amount incorrectly computed) made by taxpayers on their returns and are identified by the IRS when the returns are processed. The IRS sends math error notices to taxpayers to inform them that changes were made to their tax returns as a result of such errors.

To assess whether an analysis of math errors made on individual income tax returns could identify areas on specific forms and instructions that need improvement, we identified the 10 most commonly issued math error notices related to 2005 U.S. Individual Income Tax Returns (Form 1040) filed and processed during 2006.³ We statistically sampled and reviewed tax returns associated with those math error notices to attempt to identify the specific mistakes the taxpayers had made. We then reviewed the forms and instructions related to those errors in an attempt to determine what improvements could be made that might decrease the likelihood of another taxpayer making the same mistake.

For some of the tax returns reviewed, we were unable to identify any changes or improvements that could be made to either the forms or instructions that might reduce the number of taxpayer errors. Some of the errors were made doing complex calculations, while others were just simple mistakes. In those cases, the related forms and instructions appeared clear and informative. However, based on the remaining tax returns reviewed, we found the opposite is often true. For example, we identified a specific instance where a wording change made on the exemption line of the 2005 Form 1040 contributed to a 123 percent spike in errors made by taxpayers. Then, a subsequent change back to the original wording on the 2007 Form 1040 led to a corresponding drop in errors.

By analyzing taxpayer errors, we identified three areas where modifying Form 1040 and its associated instructions could reduce such errors. They included: 1) errors made computing the exemption amount; 2) the omission of dependent Social Security Numbers or Individual Taxpayer Identification Numbers; and 3) children claimed for the Child Tax Credit exceeding the age limit. In addition, we believe that an indepth analysis of taxpayer errors could be an effective method of improving forms and instructions and would also help determine what effect changes made to forms and instructions have upon the taxpayers using them. For each of these issues, we developed illustrations showing proposed changes to the Form 1040 that we believe would reduce the errors in these areas. We presented our ideas to professional tax preparers in a focus group setting. They provided us with their opinions and viewpoints as well as additional

³ Processing year is the calendar year in which the tax return and other tax data are processed. Processing Year 2006 is comprised primarily of Tax Year 2005 returns; however, it may also consist of prior year returns.



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ideas they had for improvements. Overall, the focus groups' reactions to our proposals were positive and in some cases we incorporated their feedback into our recommended changes.

Recommendations

We recommended that the Director, Tax Forms and Publications, Wage and Investment Division, consider additional analyses of the types and volumes of errors made by taxpayers as part of the function's obligation to improve forms and instructions. In addition, the Director, Tax Forms and Publications, Wage and Investment Division, should take steps to improve current individual income tax forms and reduce taxpayer errors by clearly denoting on the Form 1040 the purpose and description of the exemption line, that a Social Security Number or Individual Taxpayer Identification Number is required for each dependent claimed as an exemption, and the qualifying age requirement necessary to claim the Child Tax Credit.

Legislative Recommendation

Legislation is needed to allow for the judicious use of additional colors on tax returns and instructions to highlight important warnings and information.

Response

IRS management agreed with three of the four recommendations addressed to the IRS. The Tax Forms and Publications function intends to continue to analyze reports provided by the Wage and Investment Division Research Office as part of its annual revision process. The function plans to consider revisions to the exemption line and plans to modify the Child Tax Credit column in the Exemptions section of Form 1040. The IRS disagreed with our specific recommendation to add a statement that a Social Security Number or Individual Taxpayer Identification Number is required for each dependent claimed as an exemption because there are certain groups of taxpayers that are not required to provide these numbers. However, management agreed to review the suggestions presented in our report to determine whether there are other ways to highlight the need for these numbers on the tax returns. We agree with the IRS' approach.

Although the IRS did not comment on our legislative recommendation because it was outside of the IRS' jurisdiction, management agreed to conduct a review of the Forms 1040 to determine where the IRS can more effectively use shading, bolding, and other changes, such as font sizes, to highlight the most important areas of the tax forms. We will provide a copy of our report to the Department of the Treasury, Office of Tax Policy for consideration. Management's complete response to the draft report is included as Appendix IV.



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Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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Abbreviations

IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



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Background

When the Internal Revenue Service (IRS) identifies errors made by taxpayers on their individual income tax returns, it sends math error notices¹ to the taxpayers to inform them that the IRS made changes to their tax returns as a result of mathematical or clerical error(s) they made on their returns. These notices explain the specific nature of the changes (e.g., error on exemption computation, refund amount incorrectly computed) and include account statements showing how the changes affect the returns. Each math error notice is coded with a number, and the IRS tracks and compiles the total numbers of notices it sends to taxpayers each year.

Past estimates from the IRS indicate that it sends more than 100 million notices to taxpayers annually at a cost of \$472 million, with about 60 percent of these costs attributable to the downstream impact of issued notices (i.e., handling subsequent correspondence, telephone calls, and remittances from taxpayers). More than 7 million of the notices issued by the IRS are math error notices.

We initiated this audit to assess whether an analysis of math error notices issued to individual taxpayers could identify areas on specific forms and instructions that need improvement.

We initiated this audit to assess whether an analysis of math error notices issued to individual taxpayers could identify areas on specific forms and instructions that need improvement. We identified the 10 most commonly issued math error notices related to 2005 U.S. Individual Income Tax Returns (Form 1040) filed and processed during Processing Year 2006² (the 10 most common notices accounted for more than 2.3 million errors) and analyzed a statistically valid sample of the associated tax returns.

As part of this review, we developed illustrations showing possible changes to the forms that we believed would reduce the taxpayers' errors in these areas. We then presented our ideas to professional preparers in a focus group setting. They provided us with their opinions and viewpoints as well as additional ideas they had for improvements.

¹ A math error notice is sent to a taxpayer when the IRS makes a correction to a tax return to explain the changes to the taxpayer who filed the return. The notice explains the nature of the changes and how the changes affected the tax return. The ability to simply correct certain errors made by taxpayers originated out of the recognition that some errors on tax returns did not justify the expense of an audit. Congress authorized the IRS to correct certain math errors that appeared on the face of a tax return without opening an audit on the taxpayer.

² Processing year is the calendar year in which the tax return and other tax data are processed. Processing Year 2006 is comprised primarily of Tax Year 2005 returns; however, it may also consist of prior year income tax returns.



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This audit was performed at the IRS Campus³ in Ogden, Utah, and included reviews of tax returns filed nationwide. It also included discussions with employees from the Tax Forms and Publications, Submission Processing, Strategy and Finance, and Notice Gatekeeper functions in the IRS Wage and Investment Division. The focus group discussions were conducted during the 2008 IRS Nationwide Tax Forum in two locations: Las Vegas, Nevada, and Manhattan, New York. The information was collected in a structured, yet interactive manner that maximized the elicitation of the participants' thoughts, opinions, and experiences. The audit was performed during the period October 2007 through November 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

³ Campuses are the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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Results of Review

Changes to Tax Forms and Instructions Could Reduce Some of the Errors Made by Taxpayers

The IRS' Tax Forms and Publications function is responsible for creating, updating, and improving all Federal tax forms and publications. The tax forms and their instructions should inform individual taxpayers of their Federal tax obligations and enhance voluntary compliance by making it as easy as possible for taxpayers to accurately complete the tax forms.

The Tax Forms and Publications function revises and improves forms and instructions based upon customer satisfaction data, internal and external suggestions, and other information resulting from information and data gathering efforts. It also maintains open communication with other IRS functions to ensure that their needs pertaining to the tax forms and publications programs are met. Although representatives from this function indicated they did consider taxpayer errors and error volumes to help identify needed improvements or revisions to forms and instructions, they acknowledged that they did not perform analyses similar to the analyses discussed in this report.

For some of the tax returns reviewed, we were unable to identify any changes or improvements that could be made to either the forms or instructions that might reduce the number of taxpayer errors. Some of the errors were made doing complex calculations, while others were just simple mistakes. In those cases, the related forms and instructions appeared clear and informative.

However, based on the remaining tax returns reviewed, we found the opposite is often true. For example, we identified a specific instance where a wording change made on the exemption line of the 2005 Form 1040 contributed to a 123 percent spike in errors made by taxpayers. Then, a subsequent change back to the original wording on the 2007 Form 1040 led to a corresponding drop in errors.

The exemption line on the 2004 Form 1040, line 41, reads *"If line 37 is \$107,025 or less, multiply \$3,100 by the total number of exemptions claimed on line 6d. If line 37 is over \$107,025, see the worksheet on page 33."* On the 2005 Form 1040, the exemption line (now line 42) was changed to read *"If line 38 is over \$109,475, or you provided housing to a person displaced by Hurricane Katrina,⁴ see page 37. Otherwise, multiply \$3,200 by the total number of exemptions claimed on line 6d."* The errors made on this line jumped from 94,432 errors in

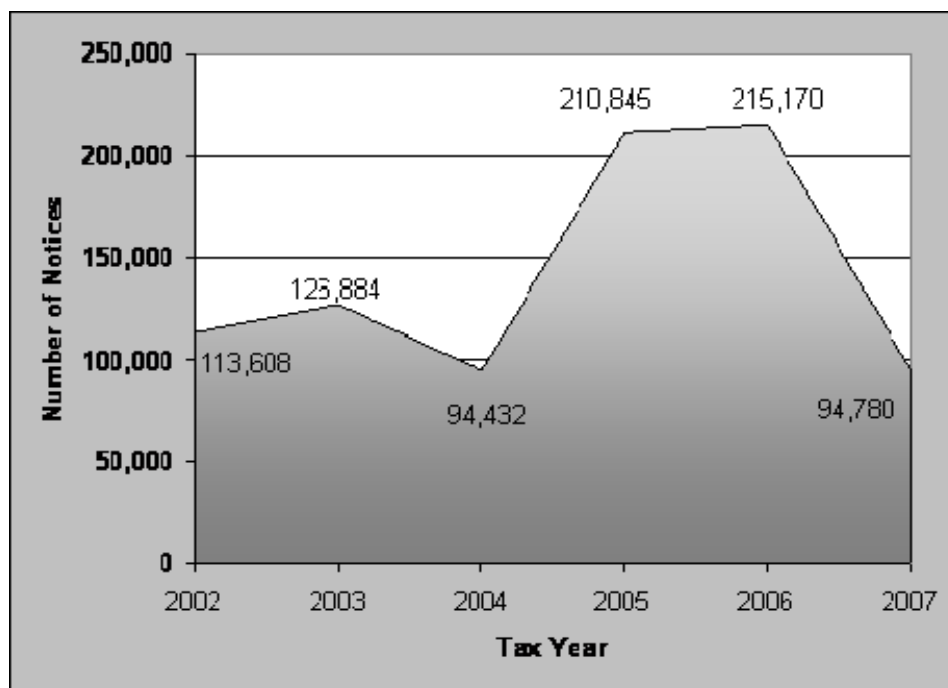
⁴ Congress acted to provide tax relief for victims of Hurricane Katrina with the Katrina Emergency Tax Relief Act of 2005 [Pub. L. No. 109-73, 119 Stat. 2016 (to be codified in scattered sections of 26 U.S.C.)]. Section 302 of this Act allows taxpayers to claim an additional exemption amount for housing Hurricane Katrina victims.



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Tax Year (TY) 2004 to 210,845 errors in TY 2005. The wording remained essentially the same on the 2006 Form 1040 and the error volumes increased slightly. However, as shown in Figure 1, it was not until the wording was changed back in TY 2007 to similar wording used in TY 2004 that the volume of errors dropped back to TY 2004 rates.

Figure 1: Exemption Computation Errors by Tax Year⁵



Source: Treasury Inspector General for Tax Administration's (TIGTA) Data Center Warehouse 2008.⁶

The correlation above indicates that changes made to the wording of this line contributed to taxpayer confusion and resulted in additional errors. Further analysis of this issue and recommendations are presented later in this report.

If the IRS had been monitoring error rates and evaluating potential causes such as the modifications it made, the IRS could have identified this problem, corrected it, and avoided wording that results in mistakes in the future. As it is, the same wording that appears to have contributed to the high error rates on the 2005 and 2006 Forms 1040 is included on the

⁵ A tax return is typically processed the year following the tax year of the return (i.e., a 2005 tax return is processed in 2006). Therefore, a processing year will also include an insignificant number of other prior year income tax returns. The tax year volumes in this figure consist primarily of the tax year shown; however, they will also include a small percentage of prior tax year returns.

⁶ The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by the TIGTA for the purpose of analyzing data for ongoing audits.



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2008 Form 1040. [The 2008 Form 1040 is the return taxpayers will file for their individual taxes during the current processing year⁷ (2009).] Due to the flooding that occurred in the Midwest during the summer of 2008, Congress passed legislation similar to that passed for the Hurricane Katrina victims. As a result, the wording used on the exemption line on the 2008 Form 1040 has been changed back to similar wording that confused taxpayers on the 2005 and 2006 Forms 1040. The exemption line on the 2008 Form 1040 reads, *"If line 38 is over \$119,975, or you provided housing to a Midwestern displaced individual, see page 36. Otherwise, multiply \$3,500 by the total number of exemptions claimed on line 6d."*

We identified three areas where modifying Form 1040 and its associated instructions could reduce taxpayer errors. They included: 1) errors made computing the exemption amount; 2) the omission of dependent Social Security Numbers (SSN) or Individual Taxpayer Identification Numbers (ITIN); and 3) children claimed for the Child Tax Credit exceeding the age limit. In addition, we believe that a regular analysis of taxpayer errors could be an effective method of improving forms and instructions and would also help determine what effect changes made to forms and instructions have upon the taxpayers using them.

The exemption line on the Form 1040 is not clearly labeled

Personal tax exemptions reduce taxable income on tax returns. For example, each personal tax exemption that was claimed on the 2005 tax return was the equivalent of a \$3,200 tax deduction. Generally, a taxpayer is allowed one tax exemption for themselves, one for their spouse if married, and one for each of their dependents.

As discussed previously, during Processing Year 2006 taxpayers made more than 210,000 errors computing their exemption amounts on their Forms 1040.⁸ A sample of these returns showed that 68 percent of the taxpayers who made this error failed to claim any qualifying exemption amount. That is, they left the exemption line blank even though they clearly qualified for an exemption amount. We identified two possible explanations for this: 1) the purpose of this line is not well identified; and, 2) the description of the line may obscure the line's main purpose with secondary information.

The exemption line on the Form 1040 has not been clearly labeled in the same manner as other line items on the Form 1040 such as "Itemized deductions," "Tax," and "total tax." These line items are labeled using bold print and the purposes of the lines are clearly marked within the descriptions. A similar label is not included for the exemption line.

We also believe that the purpose of the exemption line is made unclear with the way the secondary information is presented, which may have caused taxpayers to believe it did not apply to them. For TY 2005, the Form 1040 exemption line reads *"If line 38 is over \$109,475, or you*

⁷ Most taxpayers file their 2008 Forms 1040 during Calendar Year 2009.

⁸ A vast majority of these were TY 2005 returns. An insignificant number may have been from prior tax years.



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provided housing to a person displaced by Hurricane Katrina, see page 37. Otherwise, multiply \$3,200 by the total number of exemptions claimed on line 6d.”

Taxpayers who did not have adjusted gross income (line 38) over \$109,475 or did not provide housing to a person displaced by Hurricane Katrina, may have assumed, after reading the first sentence, that this line did not apply to their tax situation and moved on to the next line. It is not until the second sentence that taxpayers are told to multiply the number of exemptions by \$3,200 (which is the main purpose of that line).

We believe the description used prior to TY 2005 and then again in TY 2007 provided a more direct and, hence, a clearer explanation of the purpose of that line. In TY 2007, the line reads, “If line 38 is \$117,300 or less, multiply \$3,400 by the total number of exemptions claimed on line 6d. If line 38 is over \$117,300, see the worksheet on page 33.” (Wording used prior to TY 2005 was not exact but very similar). Also, in the future, when the exemption amount is affected by a single incidence such as a natural disaster, we believe the explanation should be provided as secondary information on that line.

To illustrate our point and provide a discussion item at our focus groups, we modified the exemption line on the 2005 Form 1040 to reflect the issues discussed above. We recognize that it would be of little value to correct the 2005 Form 1040 at this point but the illustration is provided as an example. Figure 2 shows the exemption line as it appears on the 2005 Form 1040. Figure 3 represents TIGTA’s modification.

Figure 2: 2005 Exemption Line

40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40
41	Subtract line 40 from line 38	41
42	If line 38 is over \$109,475, or you provided housing to a person displaced by Hurricane Katrina, see page 37. Otherwise, multiply \$3,200 by the total number of exemptions claimed on line 6d	42
43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43

Source: 2005 Form 1040.

Figure 3: 2005 Exemption Line - Modified

40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40
41	Subtract line 40 from line 38	41
42	Exemptions If line 38 is \$109,475 or less, multiply \$3,200 by the number on line 6d. If line 38 is over \$109,475, or you provided housing to a person displaced by Hurricane Katrina, see page 37	42
43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43

Source: TIGTA’s proposal to modify the 2005 Form 1040.

Focus group participants generally agreed the line should be clarified to include the “Exemptions” title. They also agreed that when additional criteria are added to the exemption line, the additional criteria should be provided as secondary information on that line.



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The Form 1040 does not include a statement indicating that an SSN or ITIN is required for each dependent being claimed as an exemption

During Processing Year 2006, more than 170,000 taxpayers failed to include their dependent's SSN or ITIN on their Forms 1040.⁹ In our sample, all taxpayers, [REDACTED] either failed to provide any SSN/ITIN or improperly wrote in the words "applied for" in place of the dependent's SSN/ITIN.¹⁰ [REDACTED]

The IRS requires that an SSN/ITIN be entered for each dependent claimed and that the name and SSN/ITIN entered agree with the number assigned to that individual by the IRS or the Social Security Administration. We found the Form 1040 instructions regarding this requirement are clear and easily accessible on both the 2005 Form 1040 instructions as well as the current 2008 Form 1040 instructions. However, there is no indication on the Form 1040 itself that the dependent's SSN/ITIN is required to claim the exemption amount.

Many taxpayers may not refer to the separate instructions for the Form 1040 when entering the identifying data for their dependents. Therefore, a caution should be added to the Form 1040 itself to ensure that taxpayers are clearly informed of the requirement, particularly since the SSN/ITIN has not always been required in the past. Printing a statement on the left margin of the Form 1040 in the Exemptions section would alert and remind taxpayers of the requirement to include an SSN/ITIN for each dependent claimed. In Figure 4, we illustrate our point by modifying the Exemptions section of the 2008 Form 1040 and added the statement "Valid SSN(s)/ITIN(s) required to receive credit for exemption(s)" in red ink.

Figure 4: Potential Change to Exemptions Section

Exemptions Valid SSN(s)/ITIN(s) required to receive credit for exemption(s). If more than four dependents, see page 17.	6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a	Box 6a on 6a			
	b <input type="checkbox"/> Spouse	No. d on 6a			
	Dependents:				
	(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 17)
					<input type="checkbox"/>
d. Total number of exemptions claimed					Add lines

Source: TIGTA's proposal to modify the Exemption section of the Form 1040.

We presented this issue and a similar illustration to the focus groups. The responding participants agreed that additional emphasis should be placed on the Form 1040 to help ensure that taxpayers are aware of the requirement. In addition, as shown in Figure 5, they offered their

⁹ A vast majority of these were TY 2005 returns. An insignificant number may have been from prior tax years.

¹⁰ In some instances prior to TY 1998, if taxpayers did not have a dependent's SSN by the time they were ready to file their tax returns, the IRS instructed them to write "Applied for" in the appropriate column. Since TY 1998, an SSN has been required for each dependent. Since the introduction of ITIN's in TY 1996, taxpayers have been required to follow the same procedures.



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own suggestions which included placing the word “REQUIRED” in bold or in red ink in the column where it requests the Dependant’s SSN/ITIN. They also suggested placing a watermark image over the entry field stating “Valid SSN/ITIN Required to Claim Exemption.” We believe that any of these proposals would help taxpayers understand that they are required to provide a valid SSN/ITIN.

Figure 5: Paid Preparers’ Suggested Changes to Exemptions Section

Exemptions		6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a			Boxe on 6a and No. of ch on 6c wh
		b <input type="checkbox"/> Spouse			• lived w
		c Dependents:	(2) Dependent's social security number *REQUIRED*	(3) Dependent's relationship to you	• did not you due to or separat (see page 17)
		(1) First name Last name			Depend not ente
If more than four dependents, see page 17.					Add num lines abo
d Total number of exemptions claimed					

Exemptions		6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a			Boxes ch on 6a and No. of ch on 6c wh
		b <input type="checkbox"/> Spouse			• lived w
		c Dependents:	(2) Dependent's social security number	(3) Dependent's relationship to you	• did not you due to or separat (see page 17)
		(1) First name Last name			Depend not ente
If more than four dependents, see page 17.			Valid SSN/ITIN Required to Claim Exemption		Add num lines abo
d Total number of exemptions claimed					

Source: Paid preparers’ proposals to modify the Exemptions section of the Form 1040.

We also discussed with the focus groups whether they believe the use of color is an effective and beneficial method of calling attention to specific issues or areas of the tax forms that need extra awareness. Currently, the IRS does not use different colors on their forms or in their instructions as a means of calling attention to or highlighting specific issues. In a previous TIGTA report,¹¹ we noted that industry literature suggests using color to emphasize information on a document. It suggests that red be used for warnings and critical items. The IRS currently uses two colors of ink for each of the Individual Income Tax Return packages (1040 – blue/black, 1040A – red/black, 1040EZ – green/black). Subsequent to negative publicity received when the IRS used multiple colors on the 1995 tax packages to enhance the artwork on the package covers, Congress provided in the Treasury Department Appropriations Act of 1997 that the IRS may use only two colors of ink on tax packages. As a result, the IRS has not subsequently pursued the use of an additional color to issue warnings and draw taxpayers’ attention to important issues on the tax returns and instructions. The majority of participants in the focus groups agreed with our

¹¹ *The Internal Revenue Service Could Enhance the Process for Implementing New Tax Legislation* (Reference Number 2000-40-029, dated March 6, 2000).



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proposal to use color, while others suggested using different fonts, uppercase lettering, bold letters, etc., to get taxpayers' attention.

As part of this audit, we reviewed a sample of State tax returns to determine whether States use color on their tax forms to draw attention to critical items. Overall, we found that 11 (55 percent) of the 20 States' tax returns reviewed used color to draw attention or highlight an area of importance on their tax forms and/or instructions. In most cases, the use of color appeared to be an effective method of directing taxpayers to important areas of the tax forms or providing a caution or a warning.

The Child Tax Credit age restrictions are not identified on the Form 1040

During Processing Year 2006, approximately 137,000 taxpayers were denied the Child Tax Credit on their Forms 1040¹² because the child claimed for the Credit exceeded the age requirement. The Child Tax Credit is a \$1,000 Credit available to taxpayers for each of their qualifying children. The child must first be considered a dependent and then meet other qualifying criteria. One of the qualifying criteria is that the child must be under age 17 at the end of the tax year.

In our sample, we found that almost 79 percent of those taxpayers that were denied the Credit claimed a child that was 17 or 18 years old (61 percent claimed a child that was 17 years old). This is an indicator that taxpayers may be unaware or confused as to when, or at what age, the child no longer qualifies for the Credit.

The section on Form 1040 where taxpayers indicate that their children qualify for the Credit is located in the "Exemptions" section. Likewise, the section of the Form 1040 instructions for determining whether their child qualifies for the Credit is also located in the "Exemptions" section under the subtitle "Line 6c-Dependents." Since the maximum age for a child to qualify for an Exemption is generally 18 years of age, and because these 2 issues have been combined on both the Form and in the instructions, taxpayers may incorrectly assume the maximum age for the Child Tax Credit is also 18.

To help taxpayers and to avoid confusing them, we believe that the qualifying birth dates for the Child Tax Credit should be clearly identified on the Form 1040 itself near the column containing the boxes to check whether the dependent(s) qualified for the Credit. We believe this would serve as an effective notice or reminder of the age requirement.

We developed two illustrations showing possible solutions that we presented to the focus groups we met with. One proposal included a watermark image on the column for the qualifying Child Tax Credit stating that the child must be "born after" a certain year. We believe that using a "born after" date, rather than just stating "must be under age 17," is a quicker and clearer method for taxpayers to determine whether their child qualifies for the Credit. (For the 2005 Form 1040,

¹² A vast majority of these were TY 2005 returns. An insignificant number may have been from prior tax years.



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the “born after” date would be 1988. The date would need to be changed each year. For example, TY 2008 would read “born after 1991.”) The other illustration presented to the focus groups suggests including a “born after” date in the description and using red ink. A third illustration was developed after the focus group discussions. See Figure 6 for all three illustrations.

Figure 6: Potential Changes to Exemptions Section – Child Tax Credit

Exemptions		6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a			Boxes on 6a	
		6b <input type="checkbox"/> Spouse			No. of	
		c Dependents:		(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 17)	on 6c	
		(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	• lived
If more than four dependents, see page 17.						• did not
						• you did
						• or sepa
						• (see pa
		d Total number of exemptions claimed				Depen not ent

Exemptions		6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a			Boxes on 6a	
		6b <input type="checkbox"/> Spouse			No. of	
		c Dependents:		(4) <input checked="" type="checkbox"/> if born after 1991 & qualified for child tax credit (see page 17)	on 6c	
		(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	• live
If more than four dependents, see page 17.						• did not
						• you did
						• or sepa
						• (see pa
		d Total number of exemptions claimed				Depen not ent

Exemptions		6a <input type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a			Boxes on 6a	
		6b <input type="checkbox"/> Spouse			No. of	
		c Dependents:		(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 17)	on 6c	
		(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	• live
If more than four dependents, see page 17.						• did not
						• you did
						• or sepa
						• (see pa
		d Total number of exemptions claimed				Depen not ent

Source: TIGTA's proposals to modify the Child Tax Credit in the Exemptions section of the Form 1040.

The focus groups' reactions to these options were positive overall and they believed that including the age requirement on the Form itself would be beneficial. However, their most common suggestion was to move the Child Tax Credit issue completely off page 1 of the Form 1040 and move it to page 2 where the Credit is actually claimed. They believed that combining the Child Tax Credit with the Exemptions amount causes confusion.

As previously mentioned, these two issues—the qualifications for Exemptions and the Child Tax Credit—have been combined on both the Form 1040 and in the instructions. More specifically, the Form 1040 has a separate line on page 2 to claim the Child Tax Credit amount, but the boxes



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used to indicate whether the taxpayer qualifies for the Credit are located on page 1 within the Exemptions section of the Form.

Similarly, the Form 1040 instructions for determining whether a child qualifies for the Child Tax Credit and the qualifying amount are in two separate areas of the instructions. One section is specifically designated for computing the Child Tax Credit. The other is combined with the Exemptions section and is included in the table used to determine if the child qualifies as a dependent. The determination of whether a child qualifies is made in this section under the heading "Does Your Qualifying Child Qualify You for the Child Tax Credit?"

We recognize that the amount of space on the Form 1040 is very limited and that moving the Child Tax Credit area from page 1 of the Form 1040 to page 2 may not be feasible at this time. However, combining the two issues that have differing requirements could be confusing to taxpayers. Therefore, if or when the IRS develops an additional form to reduce the information provided on the Form 1040, it should consider separating the two issues into their own sections on both the Form and the instructions.

Recommendations

The Director, Tax Forms and Publications, Wage and Investment Division, should:

Recommendation 1: Consider additional analyses of the types and volumes of errors made by taxpayers as part of the function's obligation to improve forms and instructions. This could help identify areas of potential improvement and help to ensure that changes to the forms and instructions do not contribute to additional errors.

Management's Response: The IRS agreed that it will need to continuously consider how additional analyses of these math errors can improve forms and instructions. The Wage and Investment Division Research Office already conducts these types of analyses and will continue to do so. The Tax Forms and Publications function plans to continue to analyze the reports provided by the Research Office, as well as customer feedback and other internal and external data, as part of its annual revision process.

Recommendation 2: Modify the exemption line on the Form 1040 and ensure that the purpose of the line is clearly labeled and the description of the line is clear and unambiguous.

Management's Response: IRS management plans to consider revisions to the exemption line after they review the error reports for TY 2008. They plan to analyze the reports to determine if the error rate for the exemption line has improved from that of TYs 2005 and 2006. If their analysis justifies it, they plan to consider making changes to the labeling and description of the exemption line.



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Recommendation 3: Add a statement or notice to page 1 of the Form 1040, within the “Exemptions” section, indicating that an SSN/ITIN is required for each dependent claimed as an exemption.

Management’s Response: IRS management disagreed with this recommendation because there are certain groups, such as the Amish, that are not required by law to provide an SSN or ITIN. However, they plan to review the suggestions presented in this report and the error reports for the 2008 tax returns to determine whether there are other ways to highlight the need for an SSN/ITIN for those required to provide one.

Office of Audit Comment: We agree with the IRS’ approach to addressing this issue.

Recommendation 4: Add a statement or notice to page 1 of the Form 1040, near the column used to mark whether the dependent(s) qualified for the Child Tax Credit, which clearly denotes the qualifying age requirement for the Credit.

Management’s Response: IRS management agreed with this recommendation. They plan to review the suggestions presented in the report and determine the best way to modify the Child Tax Credit column in the Exemptions section of Form 1040, so that it more clearly denotes the qualifying age requirement for the Credit.

Legislative Recommendation

Recommendation 5: Legislation is needed to allow for the judicious use of additional colors on tax returns and instructions to highlight important warnings and information.

Management’s Response: The IRS is not commenting on this recommendation. Matters of tax policy are within the jurisdiction of the Office of Tax Policy at the Department of the Treasury. However, management agreed to conduct a review of the Forms 1040 to determine where the IRS can more effectively use shading, bolding, and other changes, such as font sizes, to highlight the most important areas of the tax forms.

Office of Audit Comment: We will provide a copy of our report to the Department of the Treasury, Office of Tax Policy for consideration of this legislative recommendation.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine whether an analysis of Individual Master File¹ math error notices² could help the IRS identify areas on its individual income tax forms and instructions that need improvement and/or clarity. To accomplish the objective, we:

- I. Determined whether the IRS has any procedures in place to evaluate whether notices being sent to taxpayers can be reduced by actions that can be taken by the IRS.
 - A. Contacted IRS management to determine what procedures are currently in place to evaluate improvements that can be made to reduce the number of notices being sent to taxpayers.
 - B. Discussed with IRS personnel what steps had been taken to evaluate simplification or clarification of current forms and publications.
 - C. Contacted the Tax Forms and Publications function to determine the procedures it uses to determine which forms need updating for simplification.
 - D. Determined whether there was an evaluation of math error notices to determine why they have a high occurrence rate.
 - E. Determined whether any additional procedures should be performed by the IRS on a regular basis to improve this process.
- II. Determined the top 10 math error notices received by taxpayers on their tax returns.
 - A. Obtained and evaluated IRS data regarding the math error codes³ that result in a notice being sent to taxpayers. To determine the accuracy of the IRS data, we compared IRS statistics to the data available on TIGTA's Data Center Warehouse.⁴
 - B. Identified from the Data Center Warehouse the total number of each math error code that resulted in a notice that was sent to taxpayers for Processing Years 2003 through 2006.

¹ The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.

² A math error notice is sent to a taxpayer when the IRS makes a correction to a tax return to explain the changes to the taxpayer who filed the return. The notice explains the nature of the changes and how the changes affected the tax return.

³ The math error code is a three-digit code assigned to a short description of the changes contained in the math error notice.

⁴ The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by the TIGTA for the purpose of analyzing data for ongoing audits.



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- C. Identified the top 10 Individual Master File math error notices sent to taxpayers in Processing Year 2006 and downloaded a database of those taxpayers that received these notices.
 - D. From the top 10 Individual Master File math error notices, evaluated those that we believed the IRS could reduce or avoid as a result of changes or improvements to forms and/or instructions. From the tax returns with math error notices identified in Step II.C., we selected a statistical sample⁵ of 385 returns from a population 2,321,120. In selecting our sample, we used a confidence level of 95 percent, a precision rate of ± 5 percent, and an expected error rate of 50 percent.
 - E. Validated, verified, and assessed the reliability of the computer-processed data in Step II.C. by comparing the data from the database to information from the IRS Master File⁶ and found the data to be valid and reliable.
 - F. Analyzed 370 of the tax returns in the sample to determine the specific reason the taxpayer received the math error notice and evaluated whether there were improvements in education, forms, or instructions that could have been made to avoid a notice being mailed to the taxpayer.
- III. Determined whether State forms or instructions use of color could be used to reduce errors caused by a lack of clarity on the U.S. Individual Income Tax Return (Form 1040) by randomly selecting 20 States and reviewing the income tax forms and instructions for uses of color.
- IV. Obtained feedback from tax preparers regarding our proposed changes to Form 1040 that we believe would eliminate a significant number of errors many taxpayers make when completing their income tax returns by conducting focus group sessions at two of the six 2008 IRS Nationwide Tax Forum locations (Las Vegas, Nevada, and Manhattan, New York).

⁵ We selected a statistically valid sample because we wanted to project our results over the entire population of accounts.

⁶ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

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Laura Paulsen, Auditor

Roy E. Thompson, Auditor

James M. Allen, Information Technology Specialist



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Appendix III

Report Distribution List

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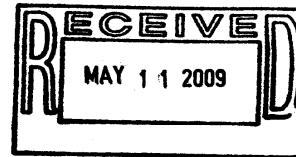
Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

MAY 11 2009



MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Analyzing Taxpayer Errors Can Help
to Improve Forms and Instructions
(Audit # 200830011)

I have reviewed your subject draft report and I appreciate your acknowledgment that the IRS revises and improves forms and instructions based upon customer satisfaction data, internal and external suggestions, and other information resulting from data gathering efforts. As you note, the IRS Tax Forms and Publications function maintains open communications with other IRS functions to ensure needs are met as they pertain to the tax forms and publications programs.

The IRS annually issues more than seven million math error notices to taxpayers to inform them that the IRS made a correction to their tax returns, and to explain the changes. While we agree that many of the math errors are due to complex calculations and simple mistakes, we also recognize some errors could result from unclear forms and instructions. To mitigate this potential, the Media and Publications (M&P) function, which interprets tax law changes and delivers the vast majority of tax products, considers customer satisfaction data, in addition to internal/external feedback on all tax products. While your report indicates the M&P function does not perform analysis similar to that discussed in your report, the Wage and Investment Division, Research Office does conduct in-depth analyses on math errors. These results are routinely shared with the M&P function. During 2008, the Research function completed a series of projects/reports profiling taxpayer errors. One example is Project #3-08-07-S-007T, dated April 2008, and titled "Can Profiling Taxpayer Segments Help IRS Implement Possible Treatments to Prevent Errors?"

Your report indicates you identified the 10 most commonly issued math error notices related to 2005 *U.S. Individual Income Tax Return* (Form 1040) filings and analyzed a statistically valid sample. You state that for some of the tax returns reviewed, you were unable to identify any changes or improvements that could be made to either the forms or instructions that might reduce the number of taxpayer errors.



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Also, your report notes three areas where you believe modifying the Form 1040, *U.S. Individual Income Tax Return*, and its associated instructions, could reduce errors. We look forward to receiving all data and findings collected during your review. The receipt of this information will allow us to consider the merits of making additional enhancements to other products.

Finally, your report includes a Legislative recommendation to allow for the judicious use of additional colors on tax returns and instructions to highlight important warnings and information. The IRS is not commenting on this recommendation. Such matters are within the jurisdiction of the Office of Tax Policy at the Department of the Treasury. We note that the additional cost of using more colors was a major factor in Congress' decision to legislatively limit the IRS's use of color on tax products. However, we will conduct a review of the 1040 forms to determine where the IRS can more effectively use shading, bolding, and other changes, such as font sizes, to highlight the most important areas of the tax forms.

Our response to your recommendations is attached. If you have any questions, please call me at (404) 338-7060, or members of your staff may contact Karen Becton-Johnson, Director, Media and Publications, Wage and Investment Division, at (202) 622-2875.

Attachment



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Attachment

The Director, Tax Forms and Publications, Wage and Investment Division, should:

RECOMMENDATION 1

Consider additional analyses of the types and volumes of errors made by taxpayers as part of the function's obligation to improve forms and instructions. This could help identify areas of potential improvement and help to ensure that changes to the forms and instructions do not contribute to additional errors.

CORRECTIVE ACTION

We agree that we need to continuously consider how additional analyses of these math errors can improve forms and instructions. The Wage and Investment (W&I) Division Research Office already conducts these types of analyses and will continue to do so. The Tax Forms and Publications function will continue to analyze the reports provided by the Research Office, as well as customer feedback and other internal and external data, as part of our annual revision process.

IMPLEMENTATION DATE

November 15, 2010

RESPONSIBLE OFFICIAL

Director, Media and Publications, W&I Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this action as part of our internal management control process.

RECOMMENDATION 2

Modify the exemption line on the Form 1040 and ensure the purpose of the line is clearly labeled and the description of the line is clear and unambiguous.

CORRECTIVE ACTION

We will consider revisions to the exemption line after we review the error reports for Tax Year (TY) 2008. We will analyze the reports to determine if the error rate for the exemption line has improved from that for TY 2005 and TY 2006. If our analysis justifies it, we will consider making changes to the labeling and description of the exemption line.

IMPLEMENTATION DATE

November 15, 2010

RESPONSIBLE OFFICIAL

Director, Media and Publications, W&I Division



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CORRECTIVE ACTION MONITORING PLAN

We will monitor this action as part of our internal management control process.

RECOMMENDATION 3

Add a statement or notice to page 1 of the Form 1040, within the "Exemptions" section, indicating that an SSN/ITIN is required for each dependent claimed as an exemption.

CORRECTIVE ACTION

We disagree with this recommendation because there are certain groups, such as the Amish, that are not required by law to provide a Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN). However, we will review the suggestions presented in your report and the error reports for the 2008 tax returns to determine whether there are other ways to highlight the need for a SSN/ITIN for those required to provide one.

IMPLEMENTATION DATE

November 15, 2010

RESPONSIBLE OFFICIAL

Director, Media and Publications, W&I Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this action as part of our internal management control process.

RECOMMENDATION 4

Add a statement or notice to page 1 of the Form 1040, near the column used to mark whether the dependent(s) qualified for the Child Tax Credit, which clearly denotes the qualifying age requirement for the Credit.

CORRECTIVE ACTION

We agree with this recommendation. We will review the suggestions presented in the report and determine the best way to modify the child tax credit column in the exemptions section of Form 1040, *U.S. Individual Income Tax Return*, so that it more clearly denotes the qualifying age requirement for the credit.

IMPLEMENTATION DATE

November 15, 2010

RESPONSIBLE OFFICIAL

Director, Media and Publications, W&I Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this action as part of its internal management control process.



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LEGISLATIVE RECOMMENDATION

RECOMMENDATION 5

Legislation is needed to allow for the judicious use of additional colors on tax returns and instructions to highlight important warnings and information.

CORRECTIVE ACTION

The IRS is not commenting on this recommendation. Matters of tax policy are within the jurisdiction of the Office of Tax Policy at the Department of the Treasury.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A